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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	**CC Docket No. 94-1**
	)	

REPLY COMMENTS OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION

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TABLE OF CONTENTS

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	)	
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REPLY COMMENTS OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION

The California Cable Television Association ("CCTA")[1/] hereby submits its reply comments in the above-captioned proceeding. CCTA's reply comments focus on the recommendations of the Local Exchange Carriers ("LECs") to rely solely on competition, rather than price-cap and other regulatory checks, to ensure just and reasonable rates for LECs' video dialtone services. The reply comments also address the LECs' recommendations for the treatment of video dialtone service if the Federal Communications Commission ("FCC" or "Commission") decides to incorporate the service within the price cap regime.

INTRODUCTION AND SUMMARY

In their initial comments, many LECs argued that video dialtone, as a service designed to be a competitive alternative in the video marketplace, need not be constrained by the regulatory requirements of price caps in order to protect and promote the public

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[1/] CCTA is a trade association representing cable television operators with over 400 cable television systems in California, including both small rural systems and national multiple system operators.

interest.[2] In the event the Commission does determine to bring video dialtone services within its price caps framework, however, the LECs also generally urged the Commission to afford them maximum flexibility in the provision of video dialtone services.

CCTA contends that the LECs' recommendation to exclude video dialtone service entirely from the price-caps framework is based upon a clear desire by the LECs to tilt the regulatory playing field in their favor. In order to fulfill the Commission's fundamental regulatory goals of preventing anticompetitive behavior and of promoting fairness in the competitive video services market, the Commission cannot proceed on this course. Competition in the video marketplace by itself is insufficient to prevent the LECs from leveraging their market power in telecommunications to gain an unfair competitive advantage in video services. In fact, although price caps have the potential to assist the Commission in fulfilling its core responsibility of promoting the public interest, even the FCC's recently modified price cap framework for LEC telecommunications services alone is insufficient to prevent the LECs from shifting the costs of video dialtone service onto telephone ratepayers.[3]

The Commission must reaffirm its commitment to thorough scrutiny of the LECs' cost studies for both video dialtone and telecommunications services (when such services are provided over a common network) to ensure the development of price floors that form the basis for rates for video dialtone service that cover all relevant costs. It's the cost studies

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[2] See, e.g., Comments of Pacific Bell ("Pacific") at 2-5.

[3] In fact, many LECs are proposing to provide video dialtone over hybrid systems ostensibly designed to carry both voice and video. See, e.g., Application of Pacific, File Nos. W-P-C 6913, et al. (January 1994).

that allow the Commission to guarantee that initial video dialtone rates are not set so low as to constitute predatory pricing. It's the cost studies that allow the Commission to determine whether the LECs have improperly shifted video dialtone service costs onto telephone services, thereby unfairly cross-subsidizing their video dialtone offerings and imposing a burden on telephone ratepayers. It's the cost studies that allow the Commission to determine what costs would have to be removed from the sharing calculation to prevent the LECs from improperly cross-subsidizing video dialtone service. And, it is these very cost studies that no LEC has yet been willing to turn over to the Commission and interested parties for the kind of careful review that is absolutely essential to accomplishing the Commission's fundamental regulatory goals.

Given the crucial role that proper assessment of video dialtone costs will play in any effort to prevent anticompetitive cross-subsidization, CCTA reiterates in these reply comments a more detailed explanation of the costing approach for video dialtone service that it recommended in its initial comments. As CCTA previously observed, and as nearly all the LEC parties continuously obscure, proper costing requires that all the incremental costs of video dialtone be assigned to that service. This is the standard the Commission has enunciated and this is the standard to which the Commission should adhere.[4/] When it does so, the Commission will find, as CCTA has demonstrated elsewhere, that the LECs' so-called "new" integrated broadband networks are not necessary at all for the continued

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[4/] Video Dialtone Reconsideration Order, 10 FCC Rcd. 244, at ¶¶ 217-220.

provision of basic telephone service.[5] In fact, but for the LECs' desire to enter the video marketplace, there is not a shred of evidence that these networks would have been proposed, let alone built. CCTA is confident that a careful review of the LECs' cost studies will reveal a massive understatement of the costs attributable to video dialtone service and a massive overstatement of the costs attributable to telephony services.

I. The Commission Should Require Video Dialtone to Come Within the Price Cap Regime to Promote Cost-Causative Pricing

Contrary to the picture painted by the LECs in their opening comments, the regulatory goal of preventing anticompetitive behavior, especially by minimizing the incentive and ability of the LECs to engage in improper cross-subsidization, is not incompatible with the objective of promoting vigorous and robust competition in the video marketplace. Indeed, prevention of cross-subsidy is an essential element to create an environment of fair competition and to ensure that the market is not artificially skewed. In this way, consumers receive the true benefits of competition whereby their alternatives are enhanced and long-run prices for video services decline. It is such fair competition that CCTA has supported in the past and continues to support openly throughout these video dialtone proceedings.[6]

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[5] FCC File Nos. W-P-C 6913 et al., Reply of the California Cable Television Association to Pacific Bell's Opposition to Petitions to Deny (hereinafter referred to as "CCTA Reply to Pacific Bell"), March 11, 1994, at 16-22, and Exhibit 3, Affidavit of Dr. Robert A. Mercer; Ex parte letters of CCTA in W-P-C 6913, to Kathleen M.H. Wallman, dated January 6, January 20, and April 11, 1995.

[6] See, e.g., Comments of CCTA in CC Docket 87-266, Fourth Further Notice of Proposed Rulemaking (filed March 21, 1995).

While the LECs may argue that video service customers will benefit in the short run if initial rates for video dialtone service are set as low as possible, even below cost, in the long run, these same customers will be worse off if the LECs succeed in engaging in predatory pricing to stymie competition.[7] Under this scenario, the LECs could ultimately raise rates to their video customers, without the constraint of either competition or regulation. And, today's telephone customers will suffer in the short-run if they are forced to bear the costs of unlawful cross-subsidization as the LECs' engage in below-cost pricing of video dialtone service through higher telephone rates. While CCTA continues to believe price caps alone will not protect fully the public interest, it is essential that the Commission set the proper stage for economically rational video dialtone pricing that both promotes competition and serves the public interest. Incorporating video dialtone into the price caps framework does just that.

A. Competition in the Video Services Market Alone Cannot Prevent Anticompetitive Behavior by the LECs

The LECs want the Commission to believe that the dangers of predatory pricing and cross-subsidization are illusory because, as new entrants into the video marketplace, the LECs would be non-dominant carriers with only a small market share.[8] This fiction fails to convey that the LECs will differ in critical aspects from carriers the Commission has previously deemed non-dominant. In stark contrast to competitors with no market power to leverage, the incumbent LECs will enter the video services market with the powerful

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[7] See Video Dialtone Reconsideration Order, 10 FCC Rcd at ¶ 216.

[8] See, e.g., GTE's Comments at 5; Southwestern Bell Comments at 2.

competitive advantage of the revenues and profits derived from their monopoly or near-monopoly provision of essential telecommunications services. They already have a wired connection into nearly every home. In fact, in many cases, the LECs intend to provide video dialtone services over precisely the same networks used to provide consumers with telephone services, over which they exercise their extraordinary market power. Thus, it is highly disingenuous, for example, for BellSouth to assert that the regulatory concerns "to protect ratepayers from substantial and precipitous changes in service rates and to prevent the LECs from engaging in predatory pricing and other anticompetitive behavior" simply do not apply to video dialtone service.[9/]

Some of the LECs take a more extreme position and argue that unless video dialtone is excluded from price caps, competition will not even emerge fully. They urge that video dialtone service must be excluded from price caps to afford the LECs sufficient pricing flexibility for this new and untested service. For example, Pacific asserts that "the best pricing strategy for video dialtone services may be an initially low price to encourage connection to the video dialtone network, then a rising price to reflect the increasing value of the network as connection becomes more widespread," a pricing strategy that may be difficult to accomplish under price caps.[10/]

Whatever the merits of permitting the LECs to depart somewhat from a traditional cost-of-service pricing scheme under which video dialtone rates would be initially high and then decrease as the investment is depreciated and fixed costs are spread over an increasing

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[9/] Comments of BellSouth Telecommunications, Inc. ("BellSouth") at 12.

[10/] Pacific Comments at 6.

volume of service, there is no justification to permit the LECs to price however they please, wholly unrelated to the costs of their new video networks, in the name of promoting competition. To so proceed creates the opportunity for the LECs to offer video dialtone service below cost initially so as to gain subscribers and market share, and then either recoup any interim losses over time through subsequent rate increases or, more likely still, never incur initial losses because they made up the revenues lost in the video services market by charging excessive rates for telephony services.

B. The Existence of Price caps for Telephony Services Will Not in Itself Prevent Improper Cross-Subsidization of Video Dialtone Rates by Telephone Ratepayers

The LECs also dismiss the possibility that they will be able to cross-subsidize video dialtone rates because the FCC's price cap scheme for telephone services prevents such conduct.[11/] Yet, this argument ignores the realities of the price cap mechanism and the numerous ways that the LECs have available today to obtain additional revenues from telephone services to offset costs for their video service.

Significantly, in California, where CCTA's members operate, the California Public Utilities Commission ("CPUC") has clearly stated that California's price caps mechanism will not offset the harm of improper allocation of video dialtone costs.[12/] Given the dual

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[11/] Bell Atlantic Comments at 5; BellSouth Comments at i.

[12/] Addressing this issue, the California PUC stated:

> California fears that if the Commission were to approve Pacific's proposed methodology without first ascertaining its effects on video dialtone competition and basic telephone rates, the resulting distortions in recorded results of operations could

(continued...)

regulatory nature of telecommunications services, even under the FCC's price cap regime, the LECs could shift the costs of video dialtone service to telephony services in the intrastate jurisdiction, where the protections of the FCC price cap plan do not apply.[13] Even though this shift may not translate into an immediate change in telephone rates, rates will rise when further rebalancing takes place to take those video dialtone costs into account. Pacific has hinted that it will request rebalancing design to the cost of basic telephone services in the

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[12](...continued)

> create significant upward pressure on basic telephone rates. While rates are set by formula under the CPUC's existing price cap regulation, companies which fail to attain a floor rate of return for two consecutive years may come to the CPUC and request relief. Accordingly, California believes that significant upward pressure on basic telephone rates could conceivably result in harm to ratepayers and interference with CPUC's ability to guard against cross-subsidization. California therefore urges the Commission explicitly to reject Pacific's proposed cost allocation methodology. Ex Parte Letter from the CPUC to Kathleen M.H. Wallman, File Nos. W-P-C 6913, et al., at 4 (January 19, 1995) ("CPUC Letter").

[13] The LECs' inconsistencies in dealing with the federal and state jurisdictions over investment and pricing issues are beginning to become apparent. In the context of price caps at the FCC, Pacific has elected the high productivity/no sharing alternative, see footnote 20, infra, and stated that such election removes the threat of cross-subsidy in the construction of its new network. See ex parte letter in W-P-C 6913 from Alan Ciamporcero to Chairman Reed E. Hundt of April 21, 1995. This election is thoroughly inconsistent with Pacific's stated desire to eliminate the productivity factor in California. See footnote 16, supra. The only way that the Commission can prevent the LECs from playing one jurisdiction off against the other is to get the facts as to costs through rigorous cost studies to ensure that video dialtone rates relate to the costs for providing such service.

context of the CPUC's current consideration of rules for local competition.[14] Thus, misassigned video dialtone costs could form the basis for increases in telephone rates, the very concern raised by the CPUC in the context of Pacific's video dialtone applications.[15] To the extent that other states regulate intrastate telephone services through similar price cap plans or through traditional cost-of-service regulation, intrastate telephone ratepayers are at risk of paying higher telephone rates to subsidize the LECs' video dialtone offerings.

Second, through their conduct now, the LECs could use the result of lower earnings (as a result of their video activities) to justify maintaining or reducing the currently adopted productivity offsets, even if productivity gains in telephony would justify even higher productivity offsets.[16] The Commission has already announced its intention to review the

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[14] For example, in Pacific's response to a recent ruling seeking comments on a procedural plan for opening California's local exchange markets to competition, Pacific stated that, unless the CPUC substantially reformed its current price cap framework, including elimination of the price cap index, rate rebalancing would be necessary. See Pacific's Response dated November 4, 1994, In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers, I.87-11-033. In a more recent filing on the impact of local competition on universal service, Pacific argued that California residential basic rates should be increased, stating that the CPUC must: "establish and periodically update an appropriate affordability standard for residential basic service, [g]radually adjust rates to the standard so the needed internal subsidy is reasonably sized." Comments of Pacific Bell in rulemaking on the Commission's own motion into universal service and to comply with the mandates of Assembly Bill 3643, R. 95-01-020, March 10, 1995.

[15] Ex Parte CPUC Letter at 2-4. The California plan also has the sharing and low-end adjustment features and the periodic reconsideration of the adopted productivity offset, Pacific Bell, 153 PUR 4th 65, 68-69 (CPUC 1994), that make it possible for the LECs to cross-subsidize video dialtone rates under the federal scheme. See infra pp. 10-11.

[16] In fact, only yesterday, Pacific announced that it is "making elimination of the productivity factor [in California] a top priority . . . ." See "Pacific Tel Woes Highlight Risks of Regulatory Change," Dow Jones/News Retrieval, May 16, 1995. Clearly, there is a legitimate question going forward regarding the way in which price caps will operate for any particular LEC.

adopted productivity offsets in the not too distant future.[17] The LECs are well aware that the Commission relied on evidence about the level of achieved LEC earnings and the frequency with which they exceeded the sharing benchmarks in its recent decision to increase the productivity offsets.[18] Given the potential impact such changes have on the ability of the LECs to manipulate earnings, the LECs have a powerful incentive now to attribute costs of video dialtone service to telephony services. By doing so, they can in effect make the earnings from telephony services appear smaller and help "justify" a lower productivity offset in the future.

Third, under today's price cap scheme, the LECs can "spend" otherwise shareable earnings from telephone services to subsidize video dialtone rates. As set forth in the First Report and Order,[19] any LEC that chooses either the low or the mid-range productivity offset has an obligation to share earnings over a set benchmark with telephone ratepayers by reducing its rates for telephone services in the following year. While many LECs have elected the highest productivity offset under which there is no sharing mechanism, not all LECs have selected this option.[20]

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[17] First Report and Order, CC Docket No. 94-1, FCC No. 95-12, at ¶¶ 150-164. Adopted March 30, 1995.

[18] Id. at ¶ 203.

[19] First Report and Order, CC Docket 94-1, at ¶ 20.

[20] See "LEC Price Cap Filings Reflect Competitive Charges," Communications Daily at 5 (May 11, 1995).

Fourth, these LECs can obtain a "low-end" adjustment if their earnings fall below the predetermined level.[21] Through the "low-end" adjustment mechanism, the LECs can manipulate the costs of video dialtone so as to inflate telephony costs. By failing to allocate properly all video dialtone-related costs, a LEC could produce a result in which reported telephony earnings fall below the low-end adjustment threshold. In effect, it would create a situation under which those costs of telephone services are overstated and the LEC recoups the video-related investment through the low-end adjustment.

Significantly, even if a LEC elects the high-end, no-sharing productivity offset under the FCC's price cap plan, it may still act upon its incentives to engage in anticompetitive conduct by manipulation of the price caps results, now and in the future. Even without sharing or the low-end adjustment, LECs still have the incentive and ability to influence the FCC to select a lower productivity adjustment in the next price cap review. Even without sharing or the low-end adjustment at the federal level, many LECs — Pacific among them — continue to be subject to state price cap plans with sharing or state cost-of-service regulation that make it possible for them to shift video dialtone costs onto basic telephone ratepayers.[22] Therefore, even price caps, with the elimination of sharing and the low end adjustment, is no panacea for the problem of LEC anticompetitive conduct.

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[21] Under the First Report and Order, LECs choosing either the 4.0 or 4.7 X factor can make the "low end adjustment" if earnings fall below 10.25%. First Report and Order at ¶ 20.

[22] See Supplemental Reply Comments of the California Cable Television Association on the Fourth Further Notice of Proposed Rulemaking, CC Docket No. 87-266 at 10-15.

Given the risks of relying solely on competition and price caps to protect the public interest, the Commission should apply price cap regulation specifically to video dialtone service, and should set the initial cap equal to the initially authorized rates for video dialtone service. If the LECs understand at the outset that video dialtone rates will be subject to price cap regulation, which will prevent them from raising video dialtone rates beyond their initially approved level (except for those increases allowed by annual application of the price cap index to the initial rates), they may hesitate somewhat before committing themselves irrevocably to below-cost rates.

II. The Commission Must Implement Price Caps for Video Dialtone So As to Avoid Skewing the Competitive Marketplace

A. The Commission Must Require that There Be A Separate Video Dialtone Only Price Cap Basket

As stated, CCTA believes that video dialtone services should be placed in a separate price caps basket to reduce the potential for cross-subsidization of video dialtone by monopoly telephone services.[23/] Contrary to the assertion of BellSouth that video dialtone service should be included with other LEC "transport" services in the trunking basket,[24/] the establishment of a separate price caps basket will help produce the Commission's public interest objectives for video dialtone.

[23/] Notably, even commenters that opposed application of price caps at all to video dialtone concurred that if the Commission were to adopt such a regime, video dialtone services should be within a separate basket. See, e.g., USTA Comments at 4. CCTA also continues to assert that it is premature to decide whether other as-yet-undeveloped broadband services should be included in the video dialtone basket. See also NYNEX Comments at 5.

[24/] BellSouth Comments at 6.

BellSouth argues that because video dialtone and the existing services in the trunking basket "all provide a transport function," "this common characteristic is sufficient to group them in a single basket."[25] Yet, this glib generalization fails to recognize that the existing services in the trunking basket transport primarily narrowband voice communications, whereas video dialtone service will transport broadband video communications. Given the inherently different nature of these services, at least today, there is no basis whatsoever to conclude that video dialtone service is functionally equivalent to the voice transport services now incorporated in the trunking basket.[26]

Finally, as a practical matter, if the Commission concludes that video dialtone services should not be subject to the existing LEC productivity offset, as most parties urge,[27] a separate video dialtone-only price cap basket is virtually required.[28]

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[25] Id. at 9, fn. 4.

[26] Significantly, even BellSouth's fellow LECs generally agree that the differences in technology and degree of competition faced sufficiently distinguish video dialtone service from existing LEC telecommunications services subject to price cap regulation to warrant the creation of a separate video dialtone price cap basket. See, e.g., GTE Comments at ii, NYNEX Comments at 2; USTA Comments at 4.

[27] See, e.g., USTA Comments at 4; NCTA Comments at 11, Southwestern Bell Comments at 4.

[28] As urged in its initial Comments, CCTA believes that the Commission should set the productivity offset at zero, if it chooses to incorporate this aspect of price caps for video dialtone service. We further note that the Comments of the Ad Hoc Telecommunications User Committee provide a particularly compelling rationale for the disaggregation of the price-cap productivity offset into a zero offset for video dialtone services and a commensurately higher offset for LEC telecommunications services. As Ad Hoc observes, this approach would "establish a virtually automatic mechanism for reallocating 'common' costs to the video category as the relative size of the LEC video business increases." Ad Hoc Comments at 13.

B. Video Dialtone Costs and Revenues Should Be Excluded from the Sharing Calculation

In their opening comments, several parties recommended that the costs and revenues of video dialtone service be excluded from the sharing calculation for other LEC services as a means of reducing the potential for cross-subsidization.[29] For instance, Bell Atlantic simply assumes that "[t]o the extent regulated telephone services are subject to earnings sharing, costs and revenue of video dialtone service would be removed from price caps and would have no impact on sharing."[30] Notably, BellSouth, Southwestern Bell and Pacific disagree. These LECs argue that if video dialtone service is subject to price caps, it should be treated the same as any other service, and its costs and revenues should be part of the sharing calculation.[31]

CCTA agrees with those parties that urge exclusion of the costs and revenues of video dialtone service from the sharing calculation as a way of reducing the risk of cross-subsidization. The assertions of BellSouth, Southwestern Bell and Pacific that there is no risk of cross-subsidization are without support. In fact, GSA provides concrete evidence as

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[29] See, e.g., GSA Comments at 7; AT&T Comments at 6; Ad Hoc Comments at 19-20.

[30] Bell Atlantic Comments at 5.

[31] BellSouth Comments at 14; Southwestern Bell Comments at 9; Pacific Bell Comments at 9.

to the risks of including video dialtone services in the overall sharing mechanism. It notes:

> Bell Atlantic, for example, expects losses measured in the tens of millions of dollars per year in its Washington, D.C. service area alone. If these losses are allowed to offset excess telephony earnings, telephone ratepayers will effectively subsidize Bell Atlantic's cable television venture.[32/]

Thus, unless the costs and revenues of video dialtone service are excluded from the calculation of shareable earnings, the scenario of cross-subsidization painted by GSA undoubtedly will be repeated in the service area of nearly every LEC offering video dialtone service (assuming they are subject to sharing). Moreover, even if the costs and revenues of LEC video dialtone offerings are removed from the sharing calculation, there is a risk of cross-subsidization through the sharing mechanism if the costs that the LECs attribute to video dialtone service (and thus removed from the sharing calculation) are less than the true costs associated with that service.

Significantly, Southwestern Bell observes that "if sharing continues, a contentious and protracted proceeding would be needed to separate video dialtone costs and revenues from the other portion of the calculations."[33/] While this argument does not necessarily militate in favor of no regulation, Southwestern Bell's comments do make clear that the Commission cannot duck the difficult — and fundamentally important — questions of cost allocation and cost-based pricing that video dialtone service raises. Therefore, although CCTA recommends that the Commission exclude video dialtone service costs and revenues from the calculation of shareable earnings, CCTA emphasizes that the success of this measure depends

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[32/] GSA Comments at 7 (emphasis in original).

[33/] Southwestern Bell Comments at 9.

entirely on the one true protection against cross-subsidization -- proper costing and pricing of video dialtone service from the outset.[34]

III. The Commission Should Reaffirm That Proper Costing and Pricing Remain the Primary Protections Against Cross-Subsidization and Anticompetitive Behavior and Require Full Cost Studies Subject to Public Comment

In light of the inherent difficulties of sorting out costs once they have been intermingled (the proverbial unscrambling of the egg), it is clear that careful Commission review of the LECs' video dialtone cost studies — with input from all interested parties — remains the essential element in any regulatory scheme to protect telephone ratepayers and video competitors from anticompetitive behavior. At every step of the way in the evaluation of a LEC's video dialtone plans, it is critical to determine what the LEC's video dialtone costs really are. Thus, in setting video dialtone rates that cover direct costs and allocated common and overhead costs, as the Commission required in the Video Dialtone

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[34] In addition, CCTA also urges that video dialtone costs and revenues be excluded from the low-end adjustment for telephony services. If costs and revenues of video dialtone service are included in determining whether LECs are entitled to raise telephone rates due to insufficient earnings, large losses in the video services market could trigger a "low-end" adjustment to telephone rates even if telephony services are profitable. No party has provided any rational basis from which to conclude that such an adjustment is needed or that the failure to include this mechanism would be confiscatory. Indeed, as the Commission has stated, video dialtone is a way in which telephone companies can voluntarily enter the video marketplace. Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd. 5781 at ¶ 13 (1992), aff'd in part and modified in part, 10 FCC Rcd. 244 (1994) ("Video Dialtone Reconsideration Order"), appeal pending sub nom., Mankato Citizens Telephone Company, No. 92-1404, Sept. 9, 1994) (D.C. Cir. filed Sept. 9, 1994). Moreover, the establishment of a low-end adjustment inappropriately shifts the risks of LEC entry into the video dialtone business to the ratepayers.

Reconsideration Order,[35] there must be knowledge and scrutiny of these cost levels. To assure that video dialtone rates equal or exceed incremental costs, which some LECs propose as a sufficient measure to protect against improper cross-subsidization,[36] there must be a careful investigation of the LECs' incremental cost studies. And, as noted by Southwestern Bell, to extract the costs of video dialtone from the sharing calculation requires knowing what the costs are.[37]

As many commenters observed, and as the Commission has already acknowledged in principle, but has yet to put fully into practice, the required investigation into video dialtone costing must be both far-reaching and fundamental. At the most basic level, the Commission must determine "which costs are truly the consequences of a carrier's decision to provide video dialtone service"[38] and then ensure that video dialtone rates recover all these costs.

Such an investigation into the video dialtone costs requires the Commission to confront fundamental questions of whether the LECs are building their broadband networks to provide video services, with telephony services being "incremental" add-ons to services requiring broadband capacity, or whether the LECs are correct in asserting that their new networks are being built to provide improved telephony services, with the capability of offering video services being simply a fortuitous benefit of the planned build and the costs of such services thus being "incremental" to the essential function of offering telephony

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[35] Video Dialtone Reconsideration Order, at ¶¶205-21.

[36] See, e.g., NYNEX Comments at 4.

[37] See Southwestern Bell Comments at 8-9.

[38] Video Dialtone Reconsideration Order at ¶217.

services.[39] As NCTA pointed out, "[s]ince the Commission has determined that video dialtone prices must, at a minimum, cover the incremental costs of video dialtone, resolution of this difference is fundamental to the allocation judgment as it has so far been defined."[40]

To this end, the Commission should conclude immediately that for many proposed integrated networks, especially those premised upon the hybrid fiber-coaxial cable architecture, video services should be treated as the "base" and telephony services as the "increment" in the relevant cost studies. This approach properly implements the principles of the Total Service Long-Run Incremental Cost ("TSLRIC") methodology that CCTA advocated in its opening comments. TSLRIC is a methodology for calculating forward-looking long-run costs for an increment of demand equal to the entire video dialtone service. Proper application of TSLRIC principles requires that all costs incurred because of the decision to offer a particular service be assigned to that service. Thus, TSLRIC would require many LECs to designate the costs of their broadband networks as costs of video dialtone service rather than narrowband telephony services.[41]

This threshold issue must be resolved properly, and the parties and the Commission must have the opportunity to scrutinize the LECs' cost studies in detail so that the Commission can require that price floors for video dialtone rates are set to recover all costs

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[39] See footnote 5, supra.

[40] NCTA Comments at 5 (footnote omitted).

[41] Depending on individual LEC circumstances, it may be appropriate for the costs of the new broadband networks to be treated as shared costs of video dialtone and other broadband services. This would not mean, however, that basic telephone services that require only narrowband capabilities should be assigned any share of the new broadband network costs.

incurred as a result of the LECs' decision to offer video dialtone service. It is simply laughable for a LEC to assert that there are no cross-subsidy concerns,[42] when the most basic questions of establishing the costs of video dialtone service have yet to be addressed by the Commission. As Ad Hoc cogently stated,

> The only truly effective means for achieving the Commission's objective — ensuring that video dialtone costs are not recovered through charges for other interstate access services — is a diligent and thorough tariff review process and the economically correct assignment of the underlying broadband network costs to the video service category.[43]

For this reason, CCTA urges the Commission to ensure that although its attention is focussed on the details of applying the price cap framework to video dialtone service, it does not lose sight of the need to focus "with laser-beam intensity" on the LECs' cost studies in support of their proposed video dialtone service offerings. Accordingly, the Commission should require all LECs planning to offer video dialtone service to prepare and submit complete and fully documented cost studies showing not only their estimated incremental costs for video dialtone, but also the incremental costs for telephony services, the joint and common costs for video and telephony services and the method for allocating joint and common costs between these service categories.[44]

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[42] NYNEX Comments at 2.

[43] Ad Hoc Comments at 4.

[44] In this regard, CCTA believes that the Bureau should adopt, as soon as possible, a detailed tariff review plan for the LECs to follow as they propose video dialtone service deployment. As with the Tariff Review Plan Order that was adopted for the virtual collocation tariffs, 9 FCC Rcd 5679 (July 25, 1994), a plan of this type would allow the Commission and interested parties to examine relevant rate structures and rate levels effectively and efficiently. In addition, it would help to ensure that full cost support material is provided. To this end, CCTA also supports the adoption of RAO Letter 25 and other

(continued...)

CONCLUSION

For the reasons set forth above, CCTA urges the Commission to conclude that a separate video dialtone price caps basket is in the public interest, as competition and price caps alone will not protect the public interest. In implementing price caps for video dialtone services, the Commission should not adopt a productivity offset and should not include video dialtone costs and revenues in sharing and the low-end adjustment mechanisms. Finally, if the Commission is to promote its overarching objectives, it must commit to a fundamental

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44/(...continued)
efforts to require LECs to account for their video dialtone costs in a uniform and verifiable manner. See Responsible Accounting Office Letter 25, DA-95-703, 60 Fed. Reg. 19591 (released April 3, 1995).

and thorough examination of video dialtone costs and reach the critical determination that all costs incurred due to a decision to deploy a particular service should be assigned to that service.

Respectfully Submitted,

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Dated: May 17, 1995

F1/39300.1

CERTIFICATE OF SERVICE

I, Cheryl S. Flood, hereby certify that on this 17th day of May, 1995, I caused copies of the foregoing Comments of The California Cable Television Association on the Further Notice of Proposed Rulemaking in CC Docket 94-1 to be sent by First Class mail, postage prepaid, or to be delivered by messenger (*) to the following:

Chairman Reed E. Hundt
Federal Communications Commission
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Room 814
Washington, DC 20554

Commissioner Andrew C. Barrett
Federal Communications Commission
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Commissioner James H. Quello
Federal Communications Commission
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Commissioner Rachelle Chong
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1919 M Street, NW
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Commissioner Susan Ness
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